

# All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions (Executive Summary).

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## All Other Things Being Equal

### A Paired Testing Study of Mortgage Lending I

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## Executive Summary

When first-time homebuyers begin shopping for a house, they learn about the house prices they can afford. This information can be provided by lending institutions, real estate agents, and mortgage brokers. But if people are not informed about mortgage financing, they may give up on their pursuit of homeownership or be unable to negotiate the most favorable loan terms. Thus, providing information is a critical phase in the homebuying process.

The U.S. Department of Housing and Urban Development conducted a study of paired testing for determining whether minority homebuyers face discrimination in the application phase of the mortgage lending process, and to provide information to metropolitan areas. The mortgage lending process consists of: (1) application to lending institutions, responses to pre-application inquiries from lending institutions, determination of loan terms and conditions, and finally, loan approval. A mortgage may take different forms at different stages.<sup>1</sup>

In a paired test, two individuals—one white and one minority—apply for home mortgage loans. Because the two members of a tester are identical except for their race or ethnicity, systematic differences in the treatment of the two applicants indicate discrimination. Paired testing has been used widely to detect and measure discrimination. Relatively small-scale investigative studies have been applied to

This study consisted of two major stages—a *pre-test* stage and a *test* stage. In the *pre-test* stage, a wide variety of paired testing scenarios, and to assess the feasibility of the study. More specifically, we conducted tests of mortgage lending institutions, construction sales agents, and mobile home sales agents. This j

conducted approximately 250 paired tests of a representative sample of mortgage lenders in Chicago, Illinois, using a standardized set of protocols in order to compare the treatment of African Americans and Hispanics in these two metropolitan areas.

## **Paired Testing Can Be an Effective Tool for Research and Enforcement**

In the first stage of this study, a total of 78 tests were conducted in Chicago and Los Angeles. Because the format of these tests, and the information provided to lenders, can produce statistical measures of the extent of discrimination. No other studies have provided forms that mortgage lending discrimination may take and about how to identify it.

The intensive pre-testing effort found that rigorous paired testing is the most effective method considered. The pilot stage focused on mortgage lending institutions and real estate agents. More research is also needed to fully understand the extent of discrimination and ethnic differences in information sources and search strategies.

The pre-test effort also found that one of the most serious forms of discrimination during the application stage is differential estimates of home price and total cost of ownership, determining where people search for housing and whether the lender is willing to finance. The phase of the Homeownership Testing Project was explicitly designed to address these issues.

Finally, pre-testing highlighted the complexity and difficulty of conducting paired tests for both testers and testing organizations than routine rental testing. This includes record keeping, as well as with the actual conduct of the tests themselves. Not all housing organizations necessarily have the capacity to effectively conduct paired testing.

## **African Americans Experience Unequal Treatment from Lenders**

The pilot phase of the Homeownership Testing Project focused on mortgage lending institutions requesting help in figuring out a path forward. The goal was to qualify, and loan products that might be suitable, to answer the question: How do African Americans and information as whites at the pre-application phase? All the tests were conducted in the Homeownership Testing Project consisted of individuals visiting offices of mortgage lenders. Testers posed as first-time homebuyers, making a general inquiry about what they could afford and what loan products might be available to them. All the tests were for A- credit products targeted to borrowers with A- credit in their respective metropolitan areas to purchase a median-priced house in their metropolitan area, but with no previous mortgage credit history. The two members of each tester pair were assigned to be of different ethnicities. The minority partner always slightly better qualified than the white partner.

In both Chicago and Los Angeles we conducted tests for a representative sample of mortgage lenders in an area that report under the Home Mortgage Disclosure Act (HMDA) that they are high-volume offices in the region that a first-time homebuyer could realistically expect to visit. These offices not only had a high probability of selection, but could also be reached by phone. This allowed us to make statements about the incidence of differential treatment that is not directly accessible to first-time homebuyers.<sup>3</sup>

The pilot test results show that in both Los Angeles and Chicago, African Americans are less likely of receiving less favorable treatment than comparable whites visit. In the majority of cases, minorities and whites receive similar treatment. However, in both metropolitan areas, it is more likely to favor the minority as the white.<sup>4</sup> But in both metropolitan areas, there is unequal treatment that systematically favor whites.<sup>5</sup>

Unequal treatment takes different forms in the two metropolitan areas.

In Los Angeles —

- Blacks were offered less coaching than comparable whites to obtain an FHA loan.
- Hispanics were denied basic information about loan amounts and terms.

follow-up compared to Anglo homebuyers.

In Chicago —

- Blacks were denied basic information about loan amount and received less follow-up than comparable white homebuyers.
- Hispanics were quoted lower loan amounts or house prices than comparable Anglo homebuyers.

These patterns of unequal treatment occurred regardless of whether the test was conducted with or without different loan officers.

<b>Adverse Treatment of African Americans and Hispanics</b>	
<b>Treatment Categories</b>	<b>Blacks</b>
	<b>Hispanics</b>
Information Requested	--
Loan amount and house price	--
Number of products	--
Coaching	Y
Follow-up contact	--
FHA encouraged	Y

Y Unequal treatment favors whites or Anglos over blacks or Hispanics  
-- No statistically significant differences in treatment

The frequency of unfavorable treatment varies considerably from city to city. In Los Angeles, unfavorable treatment occurred in the vast majority of cases, but when differences occurred, they were more likely to favor the white than the minority partner. For other treatment categories, the results were substantially more likely to favor the white than the minority partner. In Chicago, unfavorable treatment for each treatment category where statistically significant was more likely to favor the white than the minority partner.

Despite the variations in the forms that differential treatment takes, these findings demonstrate that African American and Hispanic homebuyers in both Los Angeles and Chicago face a significant risk of unequal treatment when they visit mainstream mortgage lending institutions to make pre-application inquiries. Discriminatory treatment at this early stage in the mortgage lending process has the potential to discourage some minorities from continuing their housing search, to limit their search to less desirable, higher cost homes than they could actually afford, and to prevent them from choosing the most favorable loan products.

Therefore, we conclude that paired testing at the pre-application stage of the mortgage lending process is feasible and effective for both enforcement and research purposes. Additional testing should be conducted, including systematic studies that focus on other sources of information about mortgage products and on homebuyers who are less well-qualified as borrowers. However, because of the complexity of this kind of testing and the differences between metro area results, we do not recommend a large-scale national study of discrimination at the pre-application stage of the mortgage lending process. Instead, systematic studies should be conducted on a site-by-site basis, with ample time a

## NOTES FROM EXECUTIVE SUMMARY

1. For more information on existing evidence about discrimination, see Margery Austin Turner and Felicity Skidmore. 1999. *Mortgage Lending Discrimination*. Urban Institute.
2. HMDA requires all independent mortgage companies and more than 100 home purchase and/or refinancing loans in a given year to report all applications and loans.
3. Levels and patterns of discrimination may be different for search conducted via the Internet rather than in person.
4. It is important to recognize that even when we do not observe overt discrimination in treatment, discrimination may have occurred in individual cases. This is true for whites quite frequently but favored minorities just as often as whites. While most of the staff of loan officers, but they may also include cases of discrimination against minorities.
5. Results are reported as statistically significant when the difference between minority-favored treatment is significant at a 90 percent confidence level.

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Mortgage Electronic Registration System, the aquifer floor, of course, is specified by constructive post-industrialism.

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